



UAE CT Law - Taxation of Corporations and Businesses

Overview

UAE announced introduction of Corporate Tax (CT) in January 2022. This was followed by a Public Consultation Document (PCD) in April 2022, which laid down the outline of the UAE CT law and invited comments from stakeholders.

On December 9, 2022 Federal Decree-Law No. (47) of 2022 on the Taxation of Corporations and Businesses (CT Law) was released. The CT Law is supplemented with frequently asked questions (FAQs) which provide further guidance and clarification on the provisions. This will further be supplemented by Cabinet and Ministerial decisions on specific matters.

CT Law will be effective after 15 days from the date of publication in the Official Gazette.

Stakeholders' comments on the PCD have been considered in the CT Law, which is certainly welcome.

In detail

CT Rate and Effective Date

CT rates on taxable income are as follows:

- 0% on taxable income not exceeding AED 375,000*
- 9% on taxable income exceeding AED 375,000*

CT rate on a Free Zone Person (FZP) are as follows:

- 0% on Qualifying Income*
- 9% on other taxable income

*(*to be specified in Cabinet's decision)*

CT shall be effective from a financial year beginning on or after June 1, 2023.

Dhruva Observations

CT on taxable income exceeding AED 375,000 benefits small businesses.

Taxable Person

Taxable Person can be Resident or Non-resident.



Resident Person

- Juridical person established / recognised in UAE (e.g., LLC, PSC, PJSC and so on);
- Foreign juridical persons effectively managed and controlled in UAE;
- Individuals conducting specified business or business activities;
- Unincorporated partnership that has elected to be a taxable person.

'Business' means any economic activity such as industrial, commercial, agricultural, vocational, professional, service or excavation activities or any other activity related to the use of tangible or intangible properties.

Non-resident Person

A person other than a 'resident' having:

- UAE sourced income; or
- Permanent establishment (PE) in UAE; or
- 'Nexus' in UAE.

Dhruva Observations

Individuals would be in scope of CT Law, if engaged in 'specified' business or business activities. List of specified businesses will be issued by the Cabinet.

Foreign entities having 'nexus' in UAE are sought to be brought into the CT net. As to what would constitute a nexus will be made known.

CT Base

Resident

- Juridical person – Worldwide Income;
- Individuals – Income from specified business or business activity.

Non-resident

- Income attributable to UAE PE;
- UAE sourced income; and
- Income attributable to UAE nexus.

Dhruva Observations

Personal income of individuals such as interest, investment income is outside the scope of CT Law.

UAE Sourced income (relevant for non-residents)

Income considered to be UAE sourced, if:

- derived from UAE resident person; or
- derived from non-resident person, if attributable to a UAE PE; or
- accrued or derived from activities performed, assets located, capital invested, rights used, or services performed or benefitted in the UAE.

A non-exhaustive list of income streams that would have their source in UAE has been provided.

Dhruva Observations

Source of income provisions have wide scope. Requires careful evaluation to ascertain potential CT liability.

Permanent Establishment

CT Law has provided for the following categories of PE:

- Fixed Place PE;
- Dependent Agent PE;
- Construction PE (subject to 6-month threshold).

Exemption for preparatory and auxiliary activities incorporated. Anti-abuse rules put in place to prevent possible misuse.

It has been clarified that Investment Managers providing discretionary investment / asset management services would not create a PE for foreign funds and customers, subject to certain conditions.

Natural Persons presence not to constitute PE, where presence is temporary and exceptional. Additionally, in case of employees, PE not to be constituted if:

- the activities are not core income generating activities of non-resident employer / related parties; and
- the non-resident employer does not derive any UAE sourced income.

Dhruva Observations

No PE due to employee presence is a welcome clarification.

Taxability of Free Zone Person

A FZP having adequate substance and complying with the Transfer Pricing (TP) regulations shall be subject to tax @ 0% on its 'Qualifying Income' and 9% on 'other income'. Cabinet decision will be issued to specify the scope of 'Qualifying Income'.

A FZP may elect to be subject to regular CT @ 9%. PCD stated such election to be irrevocable - no specific mention in the CT Law.

Dhruva Observations

PCD provided for certain permissible activities by an FZP in mainland, without forfeiting its 0% CT rate. Any other mainland sourced income would have disqualified FZP from 0% CT rate. It appears that such disqualification has been done away with.

Payments by a mainland entity to its related FZP may not to be subject to disallowance, provided TP regulations are complied with.

PCD had proposed a 0% withholding tax (WHT) on mainland sourced income of an FZP. This is not specifically provided in the CT Law.

Exempt Person

The following persons are exempt under CT Law:

- UAE Federal and Emirate Governments and their departments, authorities and other public institutions;
- Wholly Government-owned entities that carry mandated activity and are listed in a Cabinet Decision;
- Businesses engaged in the extraction of UAE natural resources and related non-extractive activities that are subject to Emirate-level taxation after meeting certain conditions;
- Public Benefit Entities listed in a Cabinet Decision;
- Investment Funds meeting prescribed conditions;
- Public or private pension or social security funds meeting certain conditions; and
- UAE juridical person that are wholly-owned and controlled by the exempted entities after meeting certain conditions.

Dhruva Observations

In certain cases, the exemption is not automatic and an application for exemption needs to be made to Federal Tax Authority (Authority).

It is critical to evaluate the availability of exemption. Application to be made to Authority at the earliest opportunity, once the implementing regulations are available.

Small Business Relief

UAE resident with revenue below a specified threshold and meeting specified conditions, may elect to claim "small business relief". Such taxpayer shall be treated as having no taxable income and may be subject to simplified compliance obligations.

Dhruva Observations

This helps reduce the compliance and tax burden on small businesses.

Taxable Income

Accounting income as per the standalone financial statements (FS) shall be the starting point for computing Taxable Income. FS will have to be prepared as per the acceptable accounting standards in the UAE. Accounting income will have to be adjusted by following:

- Unrealised gains and losses;
- Exempt income;
- Income arising on intra-group transfers;
- Non-deductible expenditures;
- TP adjustments;
- Transfers of tax losses within the group;
- Specified incentives or special reliefs; and
- Any other adjustments, as may be specified.

Dhruva Observations

Taxpayers will have to prepare standalone or tax grouped FS in accordance with IFRS or any other acceptable accounting standards in the UAE. Categories of Taxable persons to prepare and maintain audited FS to be notified.

Deductible and Non-deductible Expenditure

Expenses (other than capital expenses) incurred for business purpose shall be deductible.

List of non-deductible expenditures include expenses related to exempt income, donations, grants or gifts made to non-Qualifying Public Benefit Entity, fines and penalties, dividends, corporate tax and more.

Entertainment Expenditure

Only 50% of the entertainment expenditure shall be allowed as deduction. Illustrative list of entertainment expenditure - meals, accommodation, transportation, admission fees and more.

Unrealised gains or losses

A taxpayer following accrual basis, has following options for treatment of unrealised gains or losses:

- Option 1: Unrealised gains or losses on all assets and liabilities - Not taxable, until realised;
- Option 2: Unrealised gains or losses on assets and liabilities held on:
 - Capital account - Not taxable, until realised;
 - Revenue account – Taxable.

Dhruva Observations

Option to offer the gains or losses on realisation basis prevents tax outflow on unrealised gains. Deferred tax adjustments on such timing difference will have to be accounted for.

Interest Capping Rules

General

- Net interest expenditure shall be deductible up to 30% of Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA);
- Disallowed interest can be carried forward and set off up to 10 tax periods;
- Not applicable to banks, insurance providers and individuals;
- Minimum threshold of interest expenditure for applicability of interest capping rules – to be specified separately.

Specific

Interest on loan borrowed from a related party for following purposes to be disallowed:

- To finance transactions yielding exempt income to a related party; or

- Used for capital contribution / acquisition of ownership interest in a related party.

This rule not to apply if the main purpose is not to gain a tax advantage.

Dhruva Observations

Carry forward of disallowed interest is beneficial to capital intensive businesses where profits are low in the initial years.

Also, the non-inclusion of interest pursuant to an accounting classification is extremely helpful.

Exempt Income

Following incomes are exempt:

- Dividend from a UAE entity;
- Dividend from foreign entity satisfying participation exemption conditions;
- Capital gains and other income (forex gain or losses, impairment gains or losses) satisfying participation exemption conditions;
- Income of a foreign PE (if elected);
- Income of a non-resident from operating or leasing of aircrafts or ships in international transportation, provided reciprocal exemption is granted to a UAE resident.

Participation Exemption

Participation exemption condition requires:

- 5% or more ownership interest;
- Minimum holding (actual / intended) period of 12 months;
- Investee entity to be subject to tax @ 9% or more (0% rate for investee entity being an FZP);
- Not more than 50% of direct and indirect assets of the investee entity which satisfies the participation condition consists of ownership interest that would not have qualified for participation exemption, if held directly by the investor;
- Any other condition as may be prescribed.

Strategic investment beyond a threshold (to be specified in a Cabinet Decision) will be considered for participation exemption benefit, irrespective of the percentage of holding.

Dhruva Observations

Minimum holding period of 12 months is an additional condition with an intention to restrict relief to long-term investments.

Relaxation in minimum 5% ownership requirement will attract large investments in UAE entities from domestic and foreign investors.

Foreign PE Exemption

A UAE resident can elect to exempt foreign PE profits provided such PE is subject to tax in the foreign jurisdiction @ 9% or more.

Transfer Pricing

CT Law provides for a robust TP regime in line with the internationally accepted OECD Guidelines and the concept of 'arm's length' principle. The TP rules would be applicable on transactions or arrangements between related parties and connected persons.

CT Law has defined the meaning of related parties and connected persons and defines 'control' for the purpose of determining relationships.

TP methodologies

CT Law provides for one or more of the following methods to be used in arriving at an arm's length range:

- The comparable uncontrolled price method (CUP)
- The resale price method (RPM)
- The cost-plus method (CPM)
- The transactional net margin method (TNMM)
- The transactional profit split method (TPSM)

A Taxable Person may use any other method, if none of the above can be reasonably applied.

Domestic TP and cross border transactions

While CT Law provides that transactions with related parties and connected persons would be subject to the TP rules, the FAQs clarify that TP rules will apply irrespective of whether the related parties are located in UAE mainland, Free Zone or in a foreign jurisdiction, which makes the scope of TP extensive. TP rules will have to be complied with even if transactions are tax neutral (between two related and / or connected mainland persons subject to UAE CT at 9%).

Further, transactions between exempt activities (of a Government Entity, Government Controlled Entity, Extractive Business, Non-Extractive Natural Resource Business) and other business activities shall be regarded as related party transactions and subject to TP rules.

Power to adjust Taxable Income

The Authority can adjust the Taxable Income if transactions between related parties and connected persons are not within arm's length range. Where such an adjustment is made, a corresponding adjustment to the Taxable Income of the related party will also be made.

In cases where a Foreign Competent Authority makes an adjustment to a transaction or arrangement involving a Taxable Person, an application to the Authority can be made by such Taxable Person to make a corresponding adjustment.

Payments to connected persons

Any payment or benefit provided to a connected person shall be a deductible expenditure only if and to the extent such payment or benefit is at market value (market value to be determined by exercising one of the prescribed TP methods) and is incurred wholly and exclusively for business purposes.

The above provision is not applicable to:

- A Taxable Person whose shares are traded on a Recognized Stock Exchange;
- A Taxable Person that is subject to the regulatory oversight of a competent authority;
- Any other Person as may be determined in a Cabinet Decision.

TP Documentation

The following TP Documentation requirements have been prescribed under the CT Law:

- TP Disclosure Form to be filed together with the Tax Return detailing transactions and arrangements with related parties and connected persons; and
- Maintain a Master File and a Local File.

The conditions, threshold limits, prescribed form for filing / maintaining the above will be provided by notice or a Cabinet Decision.

Dhruva Observations

The TP provisions are in line with the OECD TP Guidelines.

CT Law, along with the FAQs have further explained many key aspects on which clarity was awaited, particularly on the applicability of Domestic TP and payments to connected persons.

A commanding provision is the acceptance of a combination of TP methods to determine the arm's length price. While this is a concept borrowed from the OECD TP Guidelines, many advanced tax jurisdictions do not have such a provision. This could be very beneficial for determining the arm's length nature of complex related party transactions.

Flexibility to adopt 'any other method', advanced pricing agreements for cross-border double taxation are some of the forward-looking and taxpayer-friendly provisions introduced.

A few points that need further clarification by way of a Decision are acceptability of inter-quartile range, single year vs. multi-year comparable margins, preference for use of regional comparables and conditions, threshold limits and form for TP Documentation.

Tax Grouping

CT Law allows group of companies to form a tax group and file a single tax return for the entire group, subject to the following conditions:

- Common parent company holding 95% of share capital in the group companies;
- Parent / subsidiary are not exempt persons or in Free zone availing benefit of 0% CT rate;
- All group members must use the same financial year and prepare financial statements using same accounting standards.

To form a tax group, application needs to be filed by the Parent with the Authority.

- Additional subsidiaries can be added on submission of an application;
- A group once formed can be dismantled only if approved by the Authority or when the Parent no longer holds 95%.

Tax group is treated as a single taxable person. Hence, the limit of AED 375,000 will apply irrespective of number of entities.

- Consolidated results would need to be prepared for the tax group (Intra-group transactions eliminated).

Treatment of losses on admission of a subsidiary

- Unutilised tax losses of a subsidiary prior to it forming part of a tax group would be losses of tax group and can be utilised to set off taxable income of the tax group attributable to the income of relevant subsidiary.
- If a new subsidiary forms part of the tax group, unutilised tax losses of the existing tax group cannot be set off against taxable income attributable to new subsidiary.
- If a subsidiary leaves the tax group, the subsidiary can only utilise its existing pre-grouping tax losses (if any). Losses of the tax group would continue to remain with the tax group.

Treatment of losses on cessation of tax group

- If the parent continues to remain a taxable person, entire unutilised loss will remain with the parent;
- If the parent ceases to be a taxable person, the losses of tax group shall not be available for set off with subsidiaries except to the extent of existing pre-grouping tax losses, if any.

Tax Grouping and TP implications

- Transactions between members of the same tax group are eliminated on consolidation. Accordingly, transactions between them will not be subject to TP rules.
- If a member of a tax group is required to compute the standalone taxable income to utilise tax losses incurred before joining or while leaving the tax group, then TP rules will be applicable between the said entity and other members of the same tax group.
- If a member of a tax group transacts with a related party or connected person outside its tax group, TP rules will be applicable.

Dhruva Observations

Tax grouping provisions are exhaustive. Given the restrictions on carry forward / set-off of losses in case a tax group ceases to exist, careful consideration of facts and scenarios are required before forming a tax group.

Non-applicability of TP rules within the same tax group is a taxpayer-friendly inclusion.

Tax Losses

CT Law permits carry forward of tax losses indefinitely. Set off of tax loss against taxable income is restricted to 75% of taxable income in each tax period.

Following losses cannot be carried forward:

- Losses incurred before applicability of CT Law;
- Losses incurred prior to becoming a taxable person;
- Losses incurred from exempt assets / activity.

Carry forward of losses and set off

Carry forward of losses and set off are permitted, subject to following conditions (not applicable to listed entities):

- Same shareholders should continue to hold at least 50% shareholding in the year of loss and up to the year of set off;
- In case of change in shareholding beyond 50%, same or similar business activities are carried on by the new owners.

Dhruva Observations

Allowing carry forward of losses by loss-making entities, despite change in majority shareholding would promote revival of loss-making businesses.

Transfer of losses

Inter-se transfer of losses between resident entities permissible, subject to:

- Common ownership of at least 75%;
- Taxable person transferring loss is not an entity exempt from CT or a FZP availing 0% CT;
- Both taxable persons must use the same financial year and prepare financial statements using same accounting standards.

Dhruva Observations

Where entities do not opt to form CT groups or do not meet the criteria to form CT groups, the CT Law allows entities to transfer losses, provided there is a 75% common ownership.

Transfers within a Qualifying Group and Business Restructuring

Transfer of assets and liabilities between entities (UAE resident or non-resident having a PE in UAE) would be tax neutral, subject to:

- common ownership of at least 75%;
- neither entity is an exempt person or a qualifying FZP;
- entities prepare the financial statements using same accounting standards and follow the same financial year.

Tax exemption to be withdrawn if the assets are transferred to a third-party within two years.

Similarly, provisions incorporated for providing tax neutral treatment on business restructuring (mergers, spin-offs and other transfers).

Dhruva Observations

Tax neutral provisions for intra-group asset transfers and business restructuring shall incentivize groups to reorganize their business operations.

General Anti-abuse Rules (GAAR)

Applicable to any transaction or arrangement:

- which lacks commercial substance; and
- the main purpose or one of the main purposes of such transaction or arrangement is to obtain a corporate tax advantage, otherwise not available.

Dhruva Observations

The scope of GAAR provisions is wide and aimed at preventing potential tax abuse.

Pillar Two

As per the FAQs released with the CT Law, BEPS Pillar Two Rules will be adopted by UAE in due course. Large multinational groups (MNEs) with consolidated global

revenue in excess of Euro 750 million will be subject to a different CT rate.

Dhruva Observations

The effective tax rate of a taxable person in the free zones would also change from 0% to the different rate (expected to be 15%).

Calculation of Corporate Tax Payable

Computation of Tax payable	Amounts in AED
Accounting Net Profit / Loss as per the FS	xxx
Less: Exempt Income	(xx)
Add / Less: Adjustments	xx
Taxable Income	xxx
Tax payable @ 9% above AED 375,000	xx
Less: WHT	(xx)
Less: Foreign Tax Credit	(xx)
Less: Relief	(xx)
Balance tax payable / (refundable)	xxx

Withholding Tax

0% WHT on UAE sourced income of a non-resident that is not attributable to a PE.

Dhruva Observations

Businesses need to prepare for the eventuality of the introduction of WHT on payments to non-residents.

Withholding Tax Credit

WHT credit shall be allowed against the tax payable of a tax period and the excess (if any) shall be refunded to taxpayer.

Foreign Tax Credit

- Credit of taxes paid in foreign jurisdiction would be allowed to set off against the UAE CT liability on such foreign income;
- Any excess credit shall not be allowed to be carried forward, carried backward, claim as refund or as expenditure.

Payment and refund of Corporate Tax

- Corporate tax shall be paid within 9 months from the end of the relevant tax period.
- A refund application to be filed with the tax authorities for excess WHT credit

Tax registration and de-registration

Registration

Tax registration to be obtained by every taxable person even if the taxable income does not exceed AED 375,000 or the CT liability is NIL.

No roll over of VAT registrations – Separate registrations for CT to be taken.

De-registration

De-registration possible only on cessation of business or business activity (dissolution, liquidation and so on).

To de-register, the taxable person would be required to discharge all pending CT dues / administrative penalties and file CT returns for all periods up to the date of cessation.

Tax Return

To be filed within 9 months from the end of relevant tax period.

Return to contain relevant details such as name, address and tax registration number of the taxable person, taxable income, loss relief if claimed, exemptions, details of foreign taxes and so on.

In case of a tax group, the Parent entity would be required to file the return.

Assessment and Penalties

A person shall be subject to CT assessment and imposition of penalties and fines in accordance with Tax Procedures Law and Cabinet Decisions. Authority may prescribe the conditions and circumstances under which the assessment can be conducted at the request of taxable person or issued by the Authority.

Dhruva Observations

The Tax Procedures Law specifies a time limit of 5 years from the end of relevant tax period for completion of assessment. However, where a notice for assessment



has been served within 5 years, the Authority will get another 4 years to complete the assessment.

The above could result into assessment being open for a total period of Nine years and consequently record keeping as well.

Clarifications

The Authority could be approached for:

- A clarification regarding application of the CT Law;
- Conclusion of Advance Pricing Agreements (APAs) for a transaction or arrangement proposed or entered into by a person

Form and manner of filing the applications would be provided in due course.

Dhruva Observations

Seeking clarifications / APAs would help in reducing uncertainties around taxability.

Unincorporated Partnership

Unincorporated partnership will not be taxable unless an election to be treated as a taxable person is made.

Where election not made, assets, liabilities, income and expenditure of the unincorporated partnership has to be allocated to partners in proportion of distributive shares. Partners to discharge applicable CT.

Dhruva Observations

Option to be treated as taxable person could result in simplifying the CT liability determination and payments.

If the option is taken, partners (natural persons) not having income from other business / business activities would be outside the scope of CT Law.

Family foundations

Family foundation established for identified or identifiable benefit of natural persons or for public benefit, subject to certain conditions may make an application to the Authority to be treated as unincorporated partnership.

Transitional Rules

Balance sheet as on the last day of the financial year before the beginning of a tax period, shall be considered as opening Balance sheet.

Balance sheet should be prepared considering the arm's length principle as per the CT Law. Also, there is an exception that GAAR provisions would apply to transactions or arrangements entered on or after the date of this Law published in Official Gazette.

Dhruva Observations

A plain reading gives the impression that GAAR provisions could apply even before the start of the first tax period. It would be important to see, how the Authority applies this in practice.

Other provisions

All government authorities shall co-operate with the Authority to implement the corporate tax law and shall provide any data, information and documentation of taxable and exempt person at their request.

The terms of double taxation avoidance agreement shall override the CT Law.

Dhruva Observations

Government Departments are obliged to provide data to the Authority, as and when asked for. Any data mismatch could result in scrutiny by the Authority and businesses would need to be careful in aligning data sets and reporting to various Government Departments.

Webinar:

Kindly join our webinar where our team of tax experts decode the nuances of the CT Law.

Time: December 13, 2022 at 04:00 PM (UAE time)

Webinar registration and joining link:

https://us06web.zoom.us/webinar/register/WN_SHLJF_FyETruofNUrlfHhfg

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